THE NEED OF AN EXPANSION JOINT IN OUR MONETARY SYSTEM[1]

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THE expansion joint is a well-known device in mechanics. If you should walk over the Brooklyn bridge you would see a place where steel plates slide over each other in the roadway, and if you should ask the purpose they serve you will be informed that it is an "expansion joint," to allow for the effect of heat and cold in expanding and contracting the metal of which the bridge is built. Your watch has in it a device known as the "balance wheel" which is an expansion joint to enable it to do its work correctly, regardless of the expansion by heat or the contraction by cold. Note that while the name is "expansion joint" the thing really is an expansion and contraction joint. We experience numerous ill effects because we have no expansion joint in connection with our currency or because our currency lacks elasticity.

Last year the value of our principal crops amounted to 4,652 million dollars. Practically all of this is harvested and marketed in the fall; hence we require great amounts of money to "move the crops." We hear that term very frequently but I do not think many of us realize what is implied by it. Several years ago I was in Nebraska, and with some other men was starting to drive out into the country from a town on the railroad. One of our party who lived in the town called our attention to a man driving into the place with several hogs in his wagon. He said, "That man will sell his hogs and get twenty-five or thirty dollars for them, and will spend five or six dollars for groceries and supplies, and take the balance of the money back into the country to his home ten or fifteen miles from the railroad. The next week he will repeat the operation. The money he takes

[1] An address before the Passaic Board of Trade.

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back with him each week will go to make up a fund which will last him for his family expenses until the following spring." I then woke up to the fact that several million farmers were doing the same thing all over our broad land, and I had a larger conception of what it meant to furnish money to move the crops—the cereal and other products of the west and the cotton of the south.

We can have no accurate statement of the amount of money needed each fall to move the crops, nor just how long it will be before it gets back again to the money centers; but a fair estimate would be that 200 or 300 million dollars is required each fall for this purpose and that in January, February and March nearly all of the crop-moving money will be restored to ordinary circulation. Where is the large amount of money needed each year obtained, and at what cost? The banks at the money centers carry little cash above their legal reserve. They call in demand loans to the disturbance of the security market. They refuse much-needed accommodation to merchants and manufacturers to whom they would willingly lend at other seasons of the year. They also collect all the maturing time paper which they have purchased from commercial-paper dealers from April to July. Financial strain is caused on every hand. If by such efforts in our own country money enough is not obtained, we also disturb the money centers of Europe.

So much for the inability of our currency to expand when funds are urgently needed; now a few words on the results of its inability to contract when money is unduly abundant. In the spring and early summer of 1909 when the crop-moving money had all been returned to the money centers, there was a considerable time when call money was plentiful at from 1½ to 2 per cent. In the early spring a member of a stock exchange house in New York remarked to me, "In two or three weeks the banks will be crazy with money"—his idea being that almost any rate would get it, and that the banks would not be severely critical as to the character of the collateral required. For a period of two or three months a little later than this, the dealers in commercial paper were going about among the business houses of New York, and probably elsewhere, offering

amounts of from $25,000 to $100,000 or more on single-name paper at 3½ per cent. It needs but little imagination to see how this condition leads to undue inflation of security prices, to the flotation of unwise ventures, and to the undue use of credit by the commercial and manufacturing community.

It is not entirely correct to say that we have no expansion joint in our currency system. Clearing-house certificates serve the purpose to a limited extent, but we never use them until the case is so desperate that a panic is upon us. Even when issued they fall short of serving us to the best advantage, because they do not go from city to city, and because they are not issued in small denominations for wages and small transactions, except as they were so used in a few cities in 1907 in direct violation of law. The present emergency currency law is an attempt to furnish us with elasticity, but it is not adapted to our comparatively moderate extra needs each fall. It is more for the purpose of helping us to recover after we have been seriously hurt. A few changes in the law would, I feel sure, make it extremely useful.

One very serious result of our present system is, that on the approach of bad times every wisely-managed bank begins to accumulate cash by contracting its loans in order to be prepared for anticipated stringency. Thus when the business community is in special need of accommodation the banks lend less than usual. As a result conditions are made worse. The banks are not to be blamed for such action. Indeed it is necessary for the protection of themselves and their depositors, as they have no central banking system to which they can apply later on for relief when help may be urgently needed. When undue contraction results from previous expansion, merchants with falling sales have to sacrifice stocks to realize funds to meet obligations, and the weaker ones frequently fail. Manufacturers curtail production and discharge hands. These employes, unless thrifty and possessed of means to tide them over, are reduced to poverty. Their purchasing power is cut off or diminished, and in consequence retail merchants find their business seriously lessened. Many men who have made small payments on the purchase of a house are forced through failure in business or

loss of employment to relinquish their investments, and lose what they have put in. All classes of society suffer.

A plan might be put into effect which, while it does not cover all the ground, would do much to check the evils of our over-supply of money at one season of the year, and our shortage at the other. Until we have a central bank or some other system to answer the same purpose, it would greatly help the situation, and indeed would be beneficial even after a more comprehensive plan was put into operation. This plan is so simple that it could be put into effect by four or five gentlemen in New York at a fifteen-minute conference; and yet I am confident that it would be greatly helpful.

The plan is that not less than four or five of the leading New York banks unite to discourage the accumulation of money in New York from about March to September, by lowering the rate of interest they will pay on the balances of out-of-town banks, to the extent of one-half of one per cent or more if necessary, and that from September to February they encourage the shipment of money to New York by raising the rate correspondingly. If four or five of the larger banks in New York should adopt the policy of changing the interest rate as suggested, the others would be forced to follow their example. This in turn would compel the banks of Chicago and St. Louis, the other central-reserve cities, to take similar action. The banks in the ordinary reserve cities—Philadelphia, Boston, Albany, Pittsburg, Cincinnati, and the rest—would feel the force of the action, and would be compelled to govern their action accordingly.

The average rate for call money during November 1905 was 8⅜ per cent, and during December it was 21½ per cent; in November 1906 it was 10¼ per cent, and in December 15¼ per cent; in October 1907 it was 20½ per cent, in November 16 per cent and in December over 12 per cent. As a contrast to these conditions, there was a period of six months or more in the spring and summer of 1908 when the average rate was about 1½ per cent and for six months in 1909 when it was about two per cent. Under these widely-varying conditions in the money market the New York banks make practically no change in the

rate of interest which they pay on bank balances. Not having lowered the rate when money was a drug in the market, they are not in a position to raise the rate in order to attract funds when they are greatly needed. How different is this condition from that in France, where the Bank of France, by the simple expedient of varying its rates slightly, has conferred incalculable benefit upon French trade in all its forms.

I believe that the policy I advocate would pay each individual bank in New York better than the present method, and the interest received by the out-of-town banks would average about the same as at present; but even if there should be some slight loss in either direction, it would be compensated many times over by the advantage of doing business on a more stable basis. It is sometimes said that strong financial interests desire the continuance of the present system in order that they may make large profits out of the violent changes in the money market. Of this I have no proof, but I will say that if strong financial operators desire to do business on such a basis, the present currency laws and the practise of the New York banks aid them greatly in accomplishing their purpose.

A few years ago we heard much on the subject of New York becoming the money center of the world. She cannot look forward to that distinction until our currency laws are perfected, and until her banks are prepared to do business on broad lines in harmony with the laws of supply and demand, thus doing their share in steadying the money market of the world. It is imperative for the best results in business that legislation be enacted to eliminate the evils incident to our present rigid supply of currency and credit. Business men who realize the hazard of commercial operations as now conducted should urge the remedy—a central bank under strict governmental control. Meanwhile such an interest-regulating coalition as I have suggested would provide immediate relief and would likewise constitute a valuable permanent feature of our machinery of monetary regulation.